SIME DIAMOND LEASING (MALAYSIA) SDN BHD

v.

JB PRECISION MOULDING INDUSTRIES SDN BHD

FEDERAL COURT, KUALA LUMPUR
CHONG SIEW FAI CJ (SABAH & SARAWAK)
EDGAR JOSEPH JR FCJ
MOHAMED DZAIDDIN FCJ
[CIVIL APPEAL NO: 02-5-1998]
7 NOVEMBER 1998

COMPANY LAW: *Winding-up - Set-off - Whether creditor could set off deposits paid by company against company's debts - Whether company's liquidator should recover the deposits - Whether set-off amounted to undue preference - Companies Act 1965, ss. 223 & 293 - Bankruptcy Act 1967, s. 53(1) - Conditions under which court may set aside payments and transfers - 'Relevant time' in context of s. 293(1) of Companies Act 1965 - Whether company insolvent or intended to confer preference on creditor at time when deposits were paid to creditor - Whether set-off authorised by s. 41 of Bankruptcy Act 1967 - Mutual dealings*

BANKRUPTCY: *Set-off - Creditor setting off deposits paid by company against company's debts - Whether set-off authorised under s. 41 of Bankruptcy Act 1967 - Whether there were mutual credits, debits or dealings between creditor and company - Whether right of set-off under s. 41 of Bankruptcy Act 1967 can be excluded by agreement between the parties*

The appellant entered into a lease agreement ('the agreement') with the respondent for the lease of a machine to the latter on 30 December 1988. Pursuant to the terms of the agreement ('the terms'), the respondent deposited a security deposit of RM64,500 and a prepaid rent of RM3,958 ('the deposits') with the appellant on the same date. On 2 December 1989, a winding-up petition was presented against the respondent, and the appellant, on 27 March 1990 and pursuant to the terms, gave notice to terminate the agreement (cl 14), set off the deposits against the rentals (cl 4.3) and demanded the balance outstanding. The respondent was wound up on 4 April 1990 and its liquidator demanded the return of the deposits from the appellant. The appellant refused and the liquidator applied successfully to the High Court for the same on the grounds that: (i) the deposits belonged to the estate of the respondent and the appellant was not entitled to keep them because it was neither a secured creditor within s. 2 of the Bankruptcy Act 1967 ('the BA') nor a preferential creditor within s. 292 of the Companies Act 1965 ('the CA'); (ii)

the deposits represented the assets of the respondent and the liquidator must take them under s. 233 of the CA; and (iii) the forfeiture of the deposits by the appellant was void against the liquidator as it amounted to a fraudulent and an undue preference under ss. 223 and 293 of the CA read together with s. 53(1) of the BA.

The instant appeal was from the majority decision of the Court of Appeal affirming the decision of the High Court in allowing the liquidator's application. The issue which arose for decision was whether the set-off pursuant to cl 4.3 was a voidable preference under ss. 223 and 293 of the CA read together with s. 53(1) of the BA, and, if not, whether the set-off was authorised by s. 41 of the BA.

Held:
Per Edgar Joseph Jr FCJ

[1] The court has no power to set aside payments and transfers made (in the run-up to bankruptcy) in favour of a particular creditor (which were designed to prefer him over other creditors) unless the liquidator can satisfy the court that: (i) the transaction took place within six months prior to the commencement of the winding-up; (ii) the transaction was one described in s. 53(1) of the BA; (iii) the transaction took place at a time when the company was insolvent; (iv) the transaction was effected in favour of a creditor of the company; and (iv) the transaction conferred on that creditor a preference, priority or advantage over other creditors in the winding-up.

[1a] The principle underlying s. 293(1) of the CA is that where a debtor company has, **at a relevant time**, given a preference to any person, the liquidator may apply under that section to have the preference set aside. The object of the rules of bankruptcy as to fraudulent preferences is to prevent a creditor from obtaining for himself an unfair advantage at the expense of the other creditors by concluding a transaction with the company during the twilight period preceding the winding-up of the company.

[1b] In the present case, the relevant time for determining whether the liquidator had satisfied the five conditions was **not** the date of the set-off, ie, 27 March 1990, **but** the date of the transaction pursuant to which the deposits were paid, ie, 30 December 1988, which was 11 months before the presentation of the winding-up petition on 2 December 1989. The courts below had misdirected themselves in treating the date of the set-off as the relevant time for determining whether there had been a disposition within the terms of s. 223 of the CA.

[1c] There was no evidence to show that, on the date of the transaction when the deposits passed into the hands of the appellant, the respondent was insolvent or that the parties intended to confer a preference on the appellant.

[2] Where s. 41 of the BA applies, a payment which would otherwise be set aside under s. 293 of the CA may yet be retained by the creditor, and the payment or agreement for set-off cannot be construed as a void preference under s. 53 thereof. The statutory right of set-off conferred by s. 41 of the BA cannot be excluded by agreement between the parties.

[2a] For s. 41 of the BA to apply, there must have been mutual credits, mutual debits or other mutual dealings between the parties.

[2b] In the present case, the appellant was entitled to set-off the deposits under s. 41 of the BA as there had been mutual dealings between it and the respondent. This was further reinforced by cl 4.3 of the agreement.

Per curiam:

[1] A provision for the forfeiture of a lease on winding-up does not contravene the *pari pasu* principle as it is merely a qualification of the lessee's estate. There is nothing objectionable in 'qualifying' a contractual right by a provision for the termination of the contract upon liquidation; it does not deprive the company's creditors of the benefit of an asset that would otherwise have been available to them, but merely defines the scope of the rights flowing from the contract.

[Appeal allowed.]

*[**Bahasa Malaysia** Translation Of Headnotes]*

Perayu telah memasuki perjanjian pajakan ('perjajian tersebut') dengan responden bagi pajakan sebuah jentera kepada pihak responden pada 30 Disember 1988. Selaras dengan terma-terma perjanjian tersebut ('terma tersebut'), responden telah mendepositkan satu deposit jaminan sebanyak RM64,500 dan satu sewaan yang dibayar terdahulu sebanyak RM3,958 ('deposit-deposit tersebut') dengan perayu pada tarikh yang sama. Pada 2 Disember 1989, satu petisyen penggulungan telah dikemukakan terhadap responden, dan perayu, pada 27 Mac 1990 dan selaras dengan terma-terma tersebut, telah memberikan notis untuk menamatkan perjanjian tersebut (fasal 14), menolak deposit-deposit terhadap sewaan-sewaan (fasal 4.3) dan menuntut baki yang masih belum jelas. Responden telah digulung pada 4 April 1990

dan penyelesaiannya menuntut pengembalian deposit-deposit daripada perayu. Perayu telah enggan untuk mengembalikannya dan penyelesai tersebut telah dengan jayanya memohon kepada Mahkamah Tinggi untuk mendapatkannya kembali atas alasan bahawa: (i) deposit-deposit itu kepunyaan harta pesaka responden dan perayu tidak berhak untuk menyimpannya; (ii) deposit-deposit tersebut mewakili aset-aset responden dan penyelesai semestinya menerimanya di bawah s. 233 CA tersebut; dan (iii) pelucuthakkan deposit-deposit oleh perayu adalah batal terhadap penyelesai kerana ianya membawa kepada perbuatan fraud dan suatu keutamaan yang tidak wajar di bawah s. 223 dan 293 CA tersebut yang dibaca bersesama dengan s. 53(1) BA tersebut.

Rayuan semasa ini adalah daripada keputusan majoriti Mahkamah Rayuan yang mengikrarkan keputusan Mahkamah Tinggi dalam membenarkan permohonan penyelesai tersebut. Isu yang berbangkit untuk diputuskan adalah samada penolakan selaras dengan fasal 4.3 merupakan keutamaan yang boleh batal di bawah s. 223 dan 293 CA tersebut yang dibaca bersama-sama dengan s. 53(1) BA, dan, jika tidak, samada penolakan itu dibenarkan oleh s. 41 BA tersebut.

Diputuskan:
Oleh Edgar Joseph Jr HMP

[1] Mahkamah tidak mempunyai kuasa untuk mengenepikan pembayaran-pembayaran dan pemindahan-pemindahan yang dibuat (dalam menghadapi kebankrapan) atas nama sesuatu pemiutang yang khusus (yang telah dibentuk untuk memilihnya berbanding dengan pemiutang-pemiutang yang lain) melainkan penyelesai dapat memuaskan hati mahkamah bahawa: (i) transaksi tersebut telah berlaku dalam tempoh enam bulan sebelum permulaan penggulungan tersebut; (ii) transaksi tersebut merupakan satu transaksi yang diterangkan dalam s. 53(1) BA tersebut; (iii) transaksi ini telah berlaku ketika syarikat sedang dalam keadaan insolven; (iv) transaksi itu telah dikuatkuasakan atas nama pemiutang syarikat tersebut; dan (iv) transaksi tersebut telah meletakkan pada pemiutang itu satu keutamaan atau kemanfaatan melebihi pemiutang-pemiutang yang lain dalam penggulungan tersebut.

[1a] Prinsip di sebalik s. 293(1) CA tersebut adalah bahawa di mana sesebuah syarikat penhutang telah **pada sesuatu masa yang relevan,** memberikan keutamaan kepada mana-mana orang, penyelesai boleh memohon di bawah seksyen itu supaya keutamaan tersebut diketepikan. Tujuan kaedah-kaedah kebankrapan berhubung dengan keutamaan fraud adalah untuk menghalang pemiutang daripada memperolehi bagi dirinya sendiri suatu kemanfaatan yang tidak adil sambil merugikan pemiutang yang lain dengan memuktamadkan sesuatu transaksi dengan syarikat tersebut ketika tempoh kemunduran yang mendahului penggulungan syarikat tersebut.

[1b] Dalam kes semasa, masa yang relevan bagi menentukan samada penyelesai telah menyempurnakan kelima-lima syarat **bukannya** tarikh untuk penolakkan tersebut iaitu, 27 Mac 1990, **tetapi** tarikh transaksi tersebut selaras dengan mana deposit-deposit tersebut telah dibayar, iaitu, 30 Disember 1988, yang mana adalah 11 bulan sebelum pengemukakan petisyen penggulungan pada 2 Disember 1989. Mahkamah-mahkamah di bawah telah tersalah arah dirinya sendiri dalam membuat anggapan bahawa tarikh penolakan sebagai masa yang relevan untuk menentukan samada telah terdapatnya pengaturan di dalam lingkungan terma-terma s. 223 CA tersebut.

[1c] Tidak terdapat keterangan bagi menunjukkan bahawa, pada tarikh transaksi tersebut ketika deposit-deposit beralih ke tangan perayu, responden berada dalam keadaan insolven atau bahawa pihak-pihak tersebut berniat untuk meletakkan keutamaan ke atas perayu.

[2] Di mana s. 41 BA terpakai, sesuatu pembayaran yang sebaliknya akan diketepikan di bawah s. 293 CA tersebut mungkin masih belum ditahan oleh pemiutang, dan pembayaran atau perjanjian untuk penolakan tidak boleh ditafsirkan sebagai suatu keutamaan terbatal di bawah s. 53. Hak berkanun penolakan yang diberikan oleh s. 41 BA tersebut tidak boleh dikecualikan oleh perjanjian antara pihak-pihak tersebut.

[2a] Untuk s. 41 BA tersebut menjadi terpakai, haruslah terdapatnya kredit-kredit bersaling, debit-debit bersaling atau urusan-urusan bersaling yang lain antara pihak-pihak tersebut.

[2b] Dalam kes semasa, perayu berhak untuk menolak deposit-deposit di bawah s. 41 BA tersebut kerana terdapatnya urusan-urusan bersaling antaranya dan responden. Ini adalah selanjutnya diperkukuhkan oleh fasal 4.3 perjanjian tersebut.

Per curiam:

[1] Sesuatu peruntukan untuk pelucuthakan sesuatu pajakan apabila berlakunya penggulungan tidak melanggari prinsip *pari pasu* kerana ianya adalah semata-mata suatu kelayakan harta pesaka penerima pajakan. Tidak terdapat apa-apa yang boleh dibantah dalam "melanyakkan" hak kontraktual melalui satu peruntukan untuk penamatan kontrak tersebut setelah penyelesaian; iaitu tidak melucuthak pemiutang-pemiutang syarikat dari kemanfaatan sesuatu aset yang sebaliknya mungkin tersedia ada bagi mereka, tetapi hanya mentakrifkan skop hak-hak tersebut yang datangnya daripada kontrak itu.

[Rayuan dibenarkan.]

Cases referred to:

British Eagle International Air Lines Ltd v. Compagnie Nationale Air France [1975] 1 WLR 758 ***(cit)***

Calzaturificio Zeneth Pty Ltd v. NSW Leather & Trading Co Ltd [1970] VR 605 ***(cit)***

Doe d Hunter v. Galliers [1778] 2 Term Rep 133 ***(cit)***

Eberle's Hotels and Restaurant Co Ltd v. E Jonas & Brothers [1887] 18 QBD 459 ***(refd)***

Ex parte Barter, in re Walker [1884] 26 Ch D 510 ***(cit)***

Ex parte Jackson [1880] 14 Ch D 725 ***(refd)***

Ex parte Jay, in re Harrison [1880] 14 Ch D 19 ***(cit)***

Ex parte Mackay [1873] 8 Ch App 643 ***(refd)***

Forster v. Wilson [1843] 12 M & W 191 ***(refd)***

Gye v. McIntyre [1991] 171 CLR 609 ***(foll)***

Higginbotham v. Holme [1812] 19 Ves Jun 88 ***(cit)***

Hiley v. People's Prudential Assurance Co [1938] 60 CLR 468 ***(foll)***

Ince Hall Rolling Mills Co Ltd v. Douglas Forge Company [1882] 8 QBD 179 ***(cit)***

Jack v. Kipping [1882] 9 QBD 113 ***(refd)***

JB Precision Moulding Industries Sdn Bhd v. Asia Commercial Finance (M) Sdn Bhd [1995] 1 BLJ 235 ***(ovrd)***

Lian Keow Sdn Bhd & Anor v. Overseas Credit Finance (M) Sdn Bhd [1988] 2 MLJ 449 ***(refd)***

Lloyds Bank NJA Ltd v. National Safety Council [1993] 2 VR 506 ***(cit)***

Mackinstosh v. Pogose [1895] 1 Ch D 19 ***(cit)***

National Westminister Bank Ltd v. Halesowen Presswork Ltd [1972] AC 785 ***(refd)***

Peat v. Jones & Co [1881] 8 QBD 147 ***(refd)***

Peel v. Fitzgerald [1882] Qd R 544 ***(cit)***

Re A Debtor [1927] 1 Ch 410 ***(cit)***

Re BP Fowler Ltd [1983] 3 Ch 95 ***(not foll)***

Re Johnson [1904] 1 KB 134 ***(cit)***

Re Kim San Engineers Pte Ltd [1992] 2 SLR 749 ***(foll)***

Re Piggin, Dicker v. Loambank [1962] 112 LJ 424 ***(refd)***

Re Washington Diamond Mining Company [1893] 3 Ch 95 ***(refd)***

Rolls Razor v. Cox [1967] 1 QB 552 ***(cit)***

Rouch v. Great Western Railway Company [1841] 1 QB 51 ***(cit)***

Shand v. MJ Atkinson Ltd [1966] NZLR 551 ***(cit)***

Sovereign Life Insurance v. Dodd [1892] 2 QB 673 ***(cit)***

Stein v. Blake [1995] 2 All ER 961 ***(cit)***

Stevens v. Copp [1868] LR 4 ***(cit)***

Studley v. Boylston National Bank of Boston [1913] 229 US 523 ***(refd)***

Tiley v. Bowman Ltd [1910] 1 KB 745 ***(refd)***

Whitmore v. Mason [1861] 2 John & H 204 ***(refd)***

Wilson v. Greenwood [1818] 1 Swans 471 ***(cit)***

Legislation referred to:

Bankruptcy Act 1967, ss. 2, 40, 41, 53(1)

Companies Act 1965, ss. 108(2), (3), 222, 223, 224, 233, 264, 291, 292, 293

Other sources referred to:
Legal Problems of Credit and Security, Prof Goode, 2nd edn, p 177
Principles of Corporate Insolvency, Prof Goode, 1990, p 66

For the appellant - Chang Mun Fong (Low Chi Cheng with her); M/s Lim Kian Leong & Co
For the respondent - Ong Ban Chai (Soon Eng Thye with him); M/s Ong Ban Chai & Co

[Appeal from Court of Appeal, Kuala Lumpur; Civil Appeal No: J-02-504-1995; [1997] 2 CLJ 775]

Reported by Gan Peng Chiang

JUDGMENT

Edgar Joseph Jr FCJ:

The Background Facts

In this appeal the essential facts to be garnered from the affidavits filed fall to be stated within a short compass.

The Appellant ("the Lessor") had entered into an Equipment Lease Agreement dated 30 December 1988 ("the Agreement") whereby it had leased to the Respondent ("the Lessee"), one unit "Elite E 330 B Plastic Injection Moulding Machine" with accompanying parts upon the terms and conditions appearing therein. Pursuant to those terms, the Lessee had deposited with the Lessor a pre-paid rent of RM3,958 ("the prepaid rent") and a sum of RM64,500 ("the security deposit") as security for the due performance of the Agreement. Payment of the security deposit and the prepaid rent was evidenced by a memorandum dated 30 December 1988 ("the memorandum of deposit").

For brevity and convenience we shall, unless the context otherwise requires, refer to the pre-paid rent and the security deposit as ("the deposits").

Clause 14.1(g)(ii) of the Agreement provided, *inter alia*, that in the event of a Winding-up petition being presented against the Lessee, the Lessor shall be entitled by written notice to determine and end the lease and to retake possession of the equipment.

In the events which happened, on 27 March 1990, the Lessor gave notice of termination of the said Agreement on the ground that the presentation of the Winding-up petition constituted a breach of the Agreement and, at the same time, demanding payment of the amount outstanding after setting-off the deposits pursuant to cl. 4.3 of the Agreement which provided, *inter alia*, that if the Lessee is in default under any of the provisions of the Agreement,

including the events referred to in cl. 14, then the Lessor shall be entitled to apply the deposits or any part thereof against the amount outstanding under the Agreement.

Then, on 4 April 1990, the Lessee was wound up and a Liquidator appointed. On, 23 April 1990, the Liquidator demanded from the Lessor the return of the deposits but the Lessor refused to comply.

The Proceedings

In the upshot, the Liquidator applied by way of originating motion for the refund of the deposits, which had been set-off by the Lessor. The Liquidator relied on the following grounds:

(1) the deposits paid by the Lessee belonged to the estate of the Lessee; this was so, because the Lessor being neither a secured creditor nor a preferential creditor within the meaning of s. 2 of the Bankruptcy Act 1967, and s. 292 of the Companies Act 1965, respectively, was not entitled to keep the same;

(2) the deposits represented the assets of the Lessee and thus the Liquidator must take under s. 233 of the Companies Act;

(3) the forfeiture by the Lessor of the deposits was void against the Liquidator and amounted to a fraudulent undue preference under s. 223 and s. 293 of the Companies Act, read with s. 53 of the Bankruptcy Act. The case of *Lian Keow Sdn. Bhd. (In Liquidation) & Anor. v. Overseas Credit Finance (M) Sdn. Bhd.* [1988] 2 MLJ 449 was cited in support.

We hope it is not an unfair summary of the submissions of counsel for the Lessee if we put his case thus: upon presentation of the petition – that being the material date – see, *Sovereign Life Insurance v. Dodd* [1892] 2 QB 673 – the claim in respect of the deposits had been reduced to a right of proof and that any other method of claiming the deposits would be barred by the *pari pasu* principle of distribution which is fundamental and all pervasive being enshrined in s. 264 and supported by ss. 222, 223 and 224 of the Companies Act. Furthermore, – so the submission ran – to give the Lessor the right of set-off, in the particular circumstances of this case would, in effect, give it an undue preference, over the general body of creditors, contrary to s. 293 of the Companies Act, read together with s. 53(1) of the Bankruptcy Act, and so the provisions of the Agreement which purport to give the right of set-off should be struck down as being in violation of those provisions, and, therefore, void.

Both in the High Court and the Court of Appeal (Abdul Malek, JCA, dissenting) the Liquidator succeeded. The Lessor then appealed to this court pursuant to leave to appeal having been granted.

Preliminary

It is well known that parties when dealing with each other may by contract confer upon themselves a right of set-off, the intention and effect of which is that the party who is later the defendant may contend that under the relevant Agreement he is entitled to exercise self-help by setting one obligation against the other thus extinguishing the other obligation *pro tanto*. When both parties are solvent no difficulties arise. But, with the advent of bankruptcy or a winding up of either party, contractual and equitable rights of set-off are replaced by the statutory set-off provisions the effect of which is that contractual provisions which travel beyond the perimeters of what is permitted by the statutory provisions will not survive liquidation or bankruptcy, as being in violation of the fundamental principle of *pari pasu* distribution. (See, eg *British Eagle International Air Lines Ltd. v. Compagnie Nationale Air France* [1975] 1 WLR 758).

The Issues

It is against the background of the general remarks aforesaid that we turn to consider the two key issues which arise for decision in this appeal; namely,

(1) whether the set-off pursuant to cl. 4.3 of the Agreement was a voidable preference under ss. 223 and 293 of the Companies Act, read together with s. 53(1) of the Bankruptcy Act?

(2) If "no", then whether, the set-off pursuant to the Agreement was authorised by s. 41 of the Bankruptcy Act, which is made applicable to insolvent companies by s. 291 of the Companies Act?

As to Issue (1)

A preliminary question which arises for decision on this part of the case is whether cl. 4.3 in the Agreement which provides for the determination of the lease upon presentation of a Winding-up petition was a contravention of the *pari pasu* principle which is fundamental and all pervasive. No less an authority than Professor Goode has considered this very question in his book *Principles of Corporate Insolvency* (1990) at p. 66 and has expressed the view that it does **not** since it is merely a qualification of the lessee's estate (See, *Doe d. Hunter v. Galliers* [1778] 2 Term Rep 133).

Professor Goode's opinion is supported by the following passage in the judgment of Lord Heatherley in *Whitmore v. Mason* [1861] 2 John & H 204 at p. 210:

> ... The general distinction seems to be that the owner of property may on alienation, qualify the interest of his alienee by a condition to take effect on bankruptcy; but cannot by contract or otherwise, qualify his own interest by a like condition, determining or controlling it in the event of his own bankruptcy or delay of his creditors.

It should be noted that Lord Heatherley was merely repeating a statement of principle first enunciated by Mr. Clement Swanston in a note to his report of the judgment of Lord Eldon in *Wilson v. Greenwood* [1818] 1 Swans 471.

Indeed, there is a consistent current of judicial opinion accepting the statement of principle enunciated by Mr. Clement Swanston. So, for example, in *Mackinstosh v. Pogose* [1895] 1 Ch D. 19, in a marriage settlement, if husband and wife bring property into the settlement, a trust of the income of the wife's property for the benefit of the husband until his bankruptcy, is valid. However, a similar trust of the income of the husband's property, such that the husband's interest ceases upon his bankruptcy, is invalid. Again, in a building contract situation, where the contract provided that in the event of the builder becoming bankrupt or insolvent, any of his materials and chattels lying on the premises were to be forfeited to the owner, it was held that the provision for forfeiture was an attempt to qualify the interest of the builder in his property upon the occurrence of his bankruptcy, and so was struck down as being void with the result that the building materials became the property of the trustee in bankruptcy. (See, *Ex parte Jay; in re Harrison* [1880] 14 Ch. D. 19. See also, *Rouch v. Great Western Railway Company* [1841] 1 QB 51, 64-65; *Ex parte Barter; in re Walker* [1884] 26 Ch. D. 510 (ship building contract)).

Similarly, a provision in a deed of partnership that in the event of the bankruptcy or insolvency of a partner, his share in the partnership property was to vest in his co-partners was held in *Whitmore v. Mason* 70 ER 1031 to be void for the same reason and with the same consequences.

On the other hand, there is the judgment of the Norwich County Court in *Re Piggin, Dicker v. Loambank* (His honour judge Carey Evans) (15 May 1962) 112 LJ 424. The issue which arose for decision in that case was what interest, if any, a trustee in bankruptcy, had in an Austin motor van which was in the possession of a bankrupt trader at the time of bankruptcy as hirer under a hire purchase Agreement, which, by cl. 5(iv) provided, *inter alia*, that the hiring and the Agreement should end if the hirer should commit any act of bankruptcy or have a receiving order made against him, giving the owner the right to immediate possession. It was held that the provision cl. 5(iv) was void and, therefore, not exercisable to the prejudice of the trustee in bankruptcy, at least, if he tenders the balance of the hire purchase charges. In so holding, the learned judge applied the principle in bankruptcy law enunciated by James LJ in *Ex parte Mackay* [1873] 8 Ch. App 643: by analogy:

> a man is not allowed, by stipulation with a creditor to provide for a different distribution of his effects in the event of bankruptcy from that which the law provides.

We would interpolate, to observe, that in *Ex parte Jackson* [1880] 14 Ch. D 725, 741, Cotton LJ described as a fraud on the bankruptcy law a clause that he said was an attempt to alter or disturb the legal distribution of the mortgagor's property in bankruptcy.

Reverting to Re Piggin, Professor Goode in his book, *Principles of Corporate Insolvency* (1990) at p. 66 says this:

> It is thought that this (Re Piggin etc) will not be followed. Though the doctrine of estates does not apply to chattels, the provision for termination of the Agreement on bankruptcy qualifies the possessory interest in much the same way as on a lease of property. Provisions for termination on Winding-up are commonly found in a wide range of contracts including technology licensing agreements where this effect can be devastating, destroying the company's business.

And, immediately before, on the same page of his book, Professor Goode, says this:

> A provision for forfeiture of a lease on Winding-up appears not to contravene the *pari pasu* principle since it is merely a qualification of the lessee's estate. (See, *Doe d. Hunter v. Galliers* [1787] 2 Term Rep. 133).

And, directing attention to the distinction drawn by Lord Heatherley in *Whitmore v. Mason ibid*, quoted above, Professor Goode, points out, by way of illustration, that the distinction forms the basis of the protective trust, a well established device for ensuring that an individual can have property conferred upon him without risking its forfeiture to creditors on bankruptcy, the determinable interest giving way on bankruptcy to a discretionary trust.

We prefer Professor Goode's views to those of judge Carey Evans in *Re Piggin* although we recognise the intellectual force of the reasoning of the latter. In our view, there is nothing objectionable in "qualifying" a contractual right by a provision for termination of the contract upon liquidation. (See, in *Re Johnson* [1904] 1 KB 134, 136-7). This does not operate to deprive the company's creditors of the benefit of an asset that would otherwise have been available to them, but merely operates to define the scope of the rights flowing from the contract. So, for example, a lease may provide for its determination in the event of bankruptcy. This is valid subject to relief against forfeiture because it is a reservation by the owner of property of a power over it. (See, Lord Eldon in *Higginbotham v. Holme* [1812] 19 Ves. Jun 88, 92-3; *Stevens v. Copp* [1868] LR 4 20, 23, 24).

We must now turn to consider s. 293 of the Companies Act. The law relating to fraudulent preferences is set out in s. 53 of the Bankruptcy Act, which is made applicable to companies by s. 293 of the Companies Act, and is designed to preserve the sanctity of the *pari pasu* principle by which creditors in a winding up share rateably in the assets available for distribution. As in bankruptcy cases, a creditor of a company is not entitled to a set-off against his obligation to repay the preference. (See, *In re A Debtor* [1927] 1 Ch. 410; *Calzaturificio Zeneth Pty Ltd (In Liquidation) v. N.S.W. Leather and Trading Co. Ltd.* [1970] VR 605).

We note, in passing, that in *Lian Keow Sdn. Bhd. v. Overseas Credit Finance (M) Sdn. Bhd.* [1988] 2 MLJ 449 Seah SCJ, speaking in the Supreme Court, held that the rules of bankruptcy as to fraudulent preferences are applied to the winding up of companies.

To take the matter further, it is clear law that the court has no power to make an order setting aside payments and transfers made in the run-up to bankruptcy in favour of a particular creditor which were designed to prefer him over other creditors unless the following five conditions are satisfied:

(1) that the transaction in question took place within six months prior to the commencement of winding up;

(2) that it satisfies the description of one of the types of transaction mentioned in s. 53(1) of Bankruptcy Act;

(3) that it took place at a time when the company was insolvent;

(4) that the person in whose favour the transaction was effected stood in the relation of creditor to the company; and

(5) the effect of the transaction was to confer on that person a preference, priority or advantage over other creditors in the winding up.

The onus was, of course upon the Liquidator to satisfy **all** the five requirements aforesaid.

In the High Court, at Johore Bahru, the learned judge had held that the relevant date for determining whether the Liquidator had satisfied the requirements was the date of the set-off and that at that point of time all the five requirements were satisfied. In the Court of Appeal – Abu Mansor JCA – one of the two judges who comprised the majority – shared that view.

The principle of central importance underlying s. 293(1) of the Act is that where a debtor company, has at a **relevant time,** given a preference to any person, the Liquidator may apply to the court for an order under the section setting aside the preference.

The object of the rules of bankruptcy as to fraudulent preferences is to prevent a creditor from obtaining for himself an unfair advantage at the expense of other creditors by concluding a **transaction** with the company during what has been called the twilight period which precedes winding up. Bearing this in mind, it is difficult to see how, in the present case, it could be said that the relevant date for determining whether the Liquidator had satisfied the requirements was the date of the set-off. After all, the claim for a set-off in respect of the deposits arose out of a transaction which took the form of the Agreement pursuant to which the deposits were paid as evidenced by the memorandum of deposit, execution of both these documents and the payment having been effected contemporaneously, on 30 December 1989, that is to say, as far back as 11 months before the presentation of the winding up petition.

In other words, in considering the question whether there has been a disposition within the terms of s. 223 of the Companies Act, the relevant date is **not** the date of the set-off but the date of the transaction. Thus, we are here concerned with a transaction which had been concluded long before the onset of the twilight period – statutorily defined as six months prior to the commencement of the Winding up.

It was, therefore, a serious misdirection to have treated the relevant time for purposes of s. 223 of the Companies Act as the date of the set-off. In consequence of this misdirection, both the High Court and the majority in the Court of Appeal took a wrong turning and, as a result, failed to take into account the fact that as at the time of the transaction concerned, that is to say, on 30 December 1989, when the deposits had passed into the hands of the Lessor, no evidence had been adduced to show that the Lessee was insolvent or unable to pay its debts or that the intention of the parties was to confer a preferential priority or advantage over other creditors. Indeed, it could not be gainsaid that the transaction bore all the badges of a normal straightforward transaction carried out in the normal course of the lessor's business, and wholly consistent with the industry.

It follows, that none of the five conditions aforesaid empowering the court to make an order setting aside the payments of the deposits had been satisfied.

We must therefore answer the first key issue in favour of the Lessor.

As To Issue (2)

We now turn to consider the second key issue which arose for decision.

By way of introduction to this part of the case, we think we should say a few words about the nature of insolvency set-off which, as Parke B put it in *Forster v. Wilson* [1843] 12 M. & W. 191 (at pp. 203-204), is designed "to

do substantial justice between the parties". This statement is unobjectionable if "the parties" is taken to include the bankrupt's general body of creditors. (See, *Lloyds Bank NJA Ltd v. National Safety Council* [1993] 2 VR 506, 513.)

Clearly, the legislature in providing for insolvency set-off gives legitimacy to a system of accounting whereby the party successfully asserting the set-off enjoys a preference over the general body of creditors in a manner similar to that enjoyed by a secured creditor.

To put it another way, the possibility of a set-off may be seen as a form of security (See, in *re Washington Diamond Mining Company* [1893] 3 Ch. 95, 104 where Vaughan Williams J referred to "the security by way of set-off'; also *Stein v. Blake* [1995] 2 All ER 961, 964), though it is not a security in the strict sense of the word, yet its existence, in many cases, would inspire a degree of confidence in parties dealing with each other. Indeed, in *Studley v. Boylston National Bank of Boston* [1913] 229 US 523, 529 Lamar J, speaking for the Supreme Court, cautioned that the abolition of the right of set-off could "interfere with the course of business as to produce evils of serious and far reaching consequence."

Professor Goode in his book *Legal Problems of Credit and Security* 2nd Ed. (at p. 177) has explained that the justification for the preference accorded to the party successfully asserting the set-off, is based on the notion of an express or implied Agreement, without which credit would not have been extended to the bankrupt in the first place, and by which, the creditor was to be entitled to take what was due to him out of the security in the one case and out of his own indebtedness in the other. Thus, the right of set-off enhances the provision of credit facilities and generally acts as a stimulus to trade and commerce.

Turning from the general to the particular, it is clear law that upon the advent of bankruptcy or liquidation, the rights of contractual set-off, are displaced by statutory provisions relating to set-off on insolvency. The applicable legislation relating to set-off on company Winding-up is to be found in the statutory provisions governing set-off on bankruptcy. To put it another way, the statutory provisions governing bankruptcy set-off are incorporated by reference into the provisions relating to company Winding-up; specifically, ss. 40 and 41 of the Bankruptcy Act, are incorporated by reference to companies by virtue of s. 291(2) of the Companies Act. Section 41 of the Bankruptcy Act is, of course, the section which obliges a creditor who engages in mutual dealings with the company and is also its debtor, to set-off the debts and prove only for the balance. More particularly, s. 41 says this:

> 41. (1) Where there have been mutual credits, mutual debts, or other mutual dealings between a debtor against whom a receiving order is made under this Act and any other person proving or claiming to prove a debt under such order, an account shall be taken of what is due from the one party to the other in respect of such mutual dealings, and the sum due from the one party shall be set off against any sum due from the other party, and the balance of the account and no more shall be claimed or paid on either side respectively.
>
> (2) A person shall not be entitled under this section to claim the benefit of any set-off against the property of a debtor in any case where he had at the time of giving credit to the debtor notice of an act of bankruptcy committed by the debtor and available against him.

It is important to note that the case of *Re Kim San Engineers Pte Ltd.* [1992] 2 SLR 749 shows – and we agree – that where s. 41 applies, payments which would otherwise be set aside under s. 293 of the Companies Act may yet be retained by the creditor. We hasten to add we do not overlook the case of *JB Precision Moulding Industries Sdn. Bhd. v. Asia Commercial Finance (M) Sdn. Bhd.* [1995] 1 BLJ 235; [1994] 1 MLJ 734 where the High Court refused to allow a set-off, but with respect, this case should be regarded as having been decided *per incuriam* as no reference was made therein to s. 41 of the Bankruptcy Act.

Similarly, it is important to note that the case of *In re Washington Diamond Mining Co* [1893] 3 Ch. 905 recognises that where s. 41 of the Bankruptcy Act applies the payment or Agreement for set-off cannot be construed as a void preference under s. 53 of the Bankruptcy Act. It has been said that in such a situation the fact that the debts would have been set-off in the bankruptcy means that the arrangements have not worked to the detriment of the other creditors of the company. As was well put by Vaughan Williams J in *Re Washington Diamond Mining Co. ibid* at p. 104, "You cannot prefer a man ... by merely putting him in the very position in which he would be if a bankruptcy followed".

This case should be compared with *Re B.P. Fowler Ltd.* [1983] 3 Ch. 95 where Crossman J held that the payment was a preference notwithstanding that he left open the question whether there would have been a set-off in liquidation, and on this ground his judgment may be regarded as unsatisfactory.

For the statutory set-off provisions to apply the circumstances of a case must disclose mutual credits, mutual debits or other mutual dealings. The pre-requisite of mutual dealings requires that the cross-demands must be between the same parties, and be held in the same capacity or right. (See, *Ince Hall Rolling Mills Co. Ltd. v. Douglas Forge Company* [1882] 8 QBD 179, 183). *Shand v. M.J. Atkinson Ltd.* [1966] NZLR 551, 570 *Peel v. Fitzgerald* [1882] Qd. R. 544, 547).

Clearly, the provisions of s. 41 of the Bankruptcy Act are mandatory and cannot be excluded by Agreement between the parties. The House of Lords so held in *National Westminister Bank Ltd. v. Halesowen Presswork etc. Ltd.* [1972] AC 785, HL at pp. 191, 193.

And, we would add, that it is settled law that where the circumstances of the creation of mutual liabilities are such as to show that they are related – where, for example, as in the present case, they arise out of a single contract between the parties – it is impossible for the parties to exclude even by private Agreement the statutory right of set-off conferred by s. 41 of the Bankruptcy Act. (See, *Rolls Razor v. Cox* [1967] 1 QB 552, per Denning MR. at pp. 569-570).

As to what the expression "mutual dealings" encompasses reference may be made to three cases.

In *Eberle's Hotels and Restaurant Co. Ltd. v. E. Jonas & Brothers* [1887] 18 QBD 459 Lord Esher MR said:

> There are, no doubt, matters which give rise to claims, but are not dealings within the section. If one man assaults another or injures him through negligence, that gives rise to a claim, but is not a dealing; but I am disposed to think that whatever comes within the description of an ordinary business transaction would be a dealing within the section.

Next, in *Gye v. McIntyre* [1991] 171 CLR 609, 625, the High Court of Australia held that "dealing" is used in a non-technical sense and is a term of very wide scope. Here is what the court said:

> It has been construed as referring to matter having a commercial or business flavour ... Even if it is correct to construe 'dealings' in [the set-off section] as confined to a commercial or business setting, it covers the communings, the negotiations, verbal and by correspondence, and other matters which occur or exist in that setting. Whatever may be the outer limits of the word 'dealings' in [the set-off section], it encompasses, as a matter of ordinary language, commercial transactions, and the negotiations leading up to them.

In the words of Sir Owen Dixon in *Hiley v. People's Prudential Assurance Co.* [1938] 60 CLR 468 at 497:

> It is enough that at the commencement of the winding up mutual dealings exist which involve rights and obligations whether absolute or contingent of such a nature that afterwards, in the events that happen, they mature or develop into pecuniary demands capable of set-off. If the end contemplated by the transaction is a claim sounding in money so that, in the phrase employed in the cases, it is commensurable with the cross-demand, no more is required than that at the commencement of the winding up liabilities shall have been contracted by the company and the other party respectively from which cross money claims accrue during the course of the winding up.

In our view, therefore, reciprocal obligations under a contract would, usually, be mutual. To illustrate, note the following dictum of Jessel M.R. in *Peat v. Jones & Co.* [1881] 8 QBD 147, 149 "a contract of sale and purchase is in its nature mutual imposing reciprocal obligations on the vendor and purchaser. Any claim arising out of mutual dealing could be set off'. To the same effect is the case of *Jack v. Kipping* [1882] 9 QBD 113 where the vendor of goods had been adjudged a bankrupt, and it was held that the purchaser could set-off against the trustee's claim for the price a cross-claim for damages for fraud by the vendor, in having induced the purchaser to enter into the contract of sale and purchase. Conversely, we note the case of *Tiley v. Bowman Ltd.* [1910] 1 KB 745, wherein a sale induced by the purchaser's fraud, it was held that the vendor, on rescinding the contract could set off his claim to damages for the fraud against the trustee's claim for repayment of the price.

In the present case, therefore, the Lessor was entitled to the statutory set-off provided for by s. 41 of the Bankruptcy Act, in respect of the deposits, regard being had to the fact that there had been "mutual dealings" within the meaning of the section, between it and the Lessee and the operation of the statutory set-off was reinforced by cl. 4.3 of the Agreement which authorised the Lessor to set-off the deposits against the amounts owing thereunder upon termination of the lease on the winding up.

The majority of the Court of Appeal had thus erred in law in holding, as they did in fact hold, that there had been no mutual credits, mutual debts or other mutual dealings between the Lessor and the Lessee.

On this further ground also, the Lessor is entitled to succeed in its appeal.

For the sake of completeness, we would add that the point was also taken by counsel for the Lessee company – though later abandoned – that the memorandum of deposit was not registered pursuant to s. 108 of the Companies Act, and that in consequence the entire transaction was void as against the Liquidator.

Upon this issue, both the High Court and the Court of Appeal correctly held that there was no requirement to register the memorandum of deposit because the date of the transaction was prior to the coming into force of the new s. 108(3)(k) of the Companies Act which requires a charge on the credit balance of the company in any deposit account to be registered with the registrar of companies within 30 days after its creation.

With respect, counsel for the Lessee was overstating his case, because even if his contention that there had been a breach of s. 108(1) of the Companies Act were correct, the effect would have been merely to render void the security on the company's property or undertaking but the contract or obligation for

repayment of the money secured by the charge, would be valid and enforceable, and immediately become payable. (See, s. 108(2) and (3) of the Companies Act).

The Result

In the result, the appeal is allowed with costs here and in the courts below, and the judgment of the High Court and Court of Appeal are hereby reversed. The Lessor is entitled to the set-off claimed. The deposit paid by way of security for costs must be refunded.